STATE OF MICHIGAN

COURT OF APPEALS

PEAKER SERVICES, INC., Petitioner-Appellant,	UNPUBLISHED November 26, 2013
v	No. 313983 Tax Tribunal
DEPARTMENT OF TREASURY, Respondent-Appellee.	LC No. 00-431800

Before: METER, P.J., and SERVITTO and RIORDAN, JJ.

PER CURIAM.

In this case involving Michigan's Single Business Tax Act (SBTA), MCL 208.1 *et seq.*,[1] petitioner appeals as of right the final opinion and judgment of the Michigan Tax Tribunal affirming respondent's assessment for unpaid single business taxes for tax years July 2004 through December 2007. We affirm.

I. FACTS AND PROCEDURAL HISTORY

Petitioner is a Michigan corporation engaged in the business of selling engine and generator parts to various industries located throughout North America and overseas, including rail, power, marine, manufacturing, and government industries. For the tax years in question, 30 percent of petitioner's sales also involved the sale of engine parts plus installation of those parts (hereinafter "mixed transaction sales"). These mixed transaction sales within the locomotive segment of petitioner's business are primarily the subject of respondent's assessment. A typical agreement for these mixed transaction sales required petitioner to disassemble and clean the customer's engine, put in new parts or rebuild some parts depending on the agreed-upon specification, and reassemble and test the engine before sending it back to the customer. According to petitioner's controller, "what the customer gets [in these agreements] basically is an extended life on the engine . . . for 20, 30, [or] 40 years depending on the kind of service."

When petitioner prepared its single business tax (SBT) returns for the tax years in question, it divided these mixed transaction sales such that 65 percent of the transaction was

[1] Repealed by 2006 PA 325.

characterized as the sale of tangible personal property under MCL 208.52 and was thus apportioned by "destination" to the customer's state, and the remaining 35 percent was characterized as the sale of services under MCL 208.53 and was thus apportioned by "costs of performance." When respondent conducted its audit in November 2009, however, it followed its Internal Policy Directive 2006-8 (IPD 2006-8)[2] and determined that the sales of parts and services within these mixed transaction sales could not be separated, that the entire transaction was appropriately characterized as the sale of a service, and that these transactions must be apportioned to Michigan by "costs of performance" under MCL 208.53. Respondent thus assessed against petitioner an additional $137,065 in single business taxes plus interest.

At petitioner's request, respondent held an informal conference where petitioner asserted that it was a retailer of tangible personal property, not a provider of a service, and that application of IPD 2006-8 would result in a SBT credit once the sales were apportioned to the customer's state pursuant to MCL 208.52. The referee, however, determined that petitioner provided a service under the incidental-to-service test of *Catalina Mktg Sales Corp v Dep't of Treasury*, 470 Mich 13; 678 NW2d 619 (2004), and ultimately upheld the assessment.

Petitioner then filed the instant petition in the tax tribunal, asking it to reverse respondent's decision, cancel the tax assessment, and refund petitioner $30,827 it allegedly overpaid in SBT taxes. Petitioner agreed that *Catalina Mktg's* incidental-to-service test applied, but that application of this standard mandated that the mixed transactions sales were sales of tangible personal property, causing those sales to be sourced to the customer's destination under MCL 208.52.

After a one-day hearing, the administrative law judge (ALJ) issued a proposed opinion affirming the tax assessment. The ALJ concluded that petitioner's "remanufacturing contracts are legally indistinguishable from the transactions in *Midwest Bus*[, *Corp v Dep't of Treasury*, 288 Mich App 334; 793 NW2d 246 (2010)]" in which the taxpayer rehabilitated buses and shipped them back to customers at locations outside Michigan and in which the Court of Appeals applied *Catalina Mktg* to conclude that these mixed transaction sales were essentially the provision of a service. The ALJ stated, "It is reasonably apparent that the rehabilitation of buses [in *Midwest Bus*] also involved substantial sales of parts and yet the Court required the transaction to be treated as a service for apportionment purposes." Accordingly, the ALJ held that the transactions at issue are services and affirmed the assessment.

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[2] The pertinent portion of the policy directive provides:

> In order to distinguish between the sale of a service and the sale of tangible personal property, the ultimate purpose of the transaction on the part of the purchaser must be analyzed, viewing the entire transaction as a whole, rather than examining the components of the transaction separately. If the ultimate purpose of the transaction is to purchase the performance of a service, any tangible personal property transferred as a result is incidental to providing this service, and the entire transaction will be sourced based on a costs of performance analysis. [IPD 2006-8, 5.]

Petitioner filed exceptions to the proposed order, but the tribunal rejected these exceptions and ultimately adopted the proposed opinion in its final opinion and judgment. Petitioner timely filed this appeal by right.

II. ANALYSIS

A. STANDARD OF REVIEW

The primary issue before this Court is whether the tax tribunal erred by determining that the essence of petitioner's mixed transaction sales is the provision of a service, and, thus, are appropriately sourced to Michigan by cost of performance under MCL 208.53. Our review of the tribunal's decision in this regard is limited. "Absent an allegation of fraud, this Court reviews a Tax Tribunal decision for misapplication of the law or adoption of a wrong legal principle." *Kelly Servs, Inc v Dep't of Treasury*, 296 Mich App 306, 311; 818 NW2d 482 (2012). Factual findings are "conclusive if they are supported by competent, material, and substantial evidence on the whole record." *Malpass v Dep't of Treasury*, 494 Mich 237, 245; 833 NW2d 272 (2013) (internal quotation marks and citation omitted). However, when questions of statutory construction are involved this Court's review is de novo. *Id*.

B. THE SBTA

The SBTA imposes a tax on the privilege of conducting business activities in Michigan. See *Fluor Enterprises v Dep't of Treasury*, 477 Mich 170, 174; 730 NW2d 722 (2007). To accomplish this purpose, the SBTA imposes a tax on the adjusted tax base of every person conducting business activity allocated or apportioned to the state of Michigan. MCL 208.31(1). The act defines "tax base" as "business income" subject to various adjustments, MCL 208.9(1), and effectively converts an income tax to a value added tax in furtherance of the act's purpose. *Jefferson Smurfit Corp v Dep't of Treasury*, 248 Mich App 271, 273; 639 NW2d 269 (2001).

Different formulas for determining SBT liability apply, depending on whether the taxpayer conducts business solely in Michigan or also in other states such that it is a multistate taxpayer. If the taxpayer's business activities are conducted solely within the state, then its entire adjusted tax base is allocated to Michigan and is subject to the applicable tax rate. MCL 208.31(1); MCL 208.40. When a taxpayer conducts taxable business activities both within and outside Michigan, like petitioner in the present matter, the SBTA requires the taxpayer to apportion its tax base by applying the applicable apportionment formula, such that only those transactions appropriate to be taxed in Michigan are taxed here. MCL 208.41. For example, the apportionment formula excludes from taxation a multistate taxpayer's sale of goods to a customer located in another state because the sale did not occur in Michigan.

The apportionment formula for the tax years in question multiplies the taxpayer's tax base by a percentage, which is the sum of property, payroll, and sales factors. MCL 208.45a(1)

and (2).[3] Each of these factors is a fraction reflecting the ratio of Michigan activity to out-of-state activity. For example, the sales factor, which is at issue in the present matter, is a fraction that contains total Michigan sales in its numerator and total sales of the taxpayer everywhere in its denominator (Michigan sales/Total sales). MCL 208.51(1).

Whether petitioner's mixed transaction sales are Michigan sales and included in the Michigan sales numerator, as respondent and the tribunal concluded, is dependent on whether the sales are categorized as sales of tangible personal property or sales of a service.[4] Specifically,

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[3] Specifically, for the tax years in question, MCL 208.45a(1) and (2) provided in relevant part as follows:

> (1) Except as provided in subsection (4) and for tax years beginning after December 31, 1998 and before January 1, 2006, all of the tax base . . . shall be apportioned to this state by multiplying the tax base by a percentage, which is the sum of all of the following percentages:
>
> (a) The property factor multiplied by 5%.
>
> (b) The payroll factor multiplied by 5%.
>
> (c) The sales factor multiplied by 90%.
>
> (2) For tax years beginning after December 31, 2005 and before January 1, 2008, all of the tax base . . . shall be apportioned to this state by multiplying the tax base by a percentage, which is the sum of all of the following percentages:
>
> (a) The property factor multiplied by 3.75%.
>
> (b) The payroll factor multiplied by 3.75%.
>
> (c) The sales factor multiplied by 92.5%.

[4] MCL 208.7 defines "sale" or "sales" to mean:

> the amounts received by the taxpayer as consideration from the following:
>
> (*i*) The transfer of title to, or possession of, property that is stock in trade or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the tax period or property held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business.
>
> (*ii*) The performance of services, which constitute business activities other than those included in subparagraph (*i*), or from any combination of business activities described in this subparagraph and subparagraph (*i*).

MCL 208.52(b) indicates, in part, that sales of tangible personal property are Michigan sales if "the property is shipped or delivered to any purchaser within this state regardless of the free on board point or other conditions of the sales." Comparatively, MCL 208.53 pertains to the performance of services, i.e., sales other than tangible personal property or a combination thereof, and provides in part:

> Sales, other than sales of tangible personal property, are in this state if:
>
> (a) The business activity is performed in this state.
>
> (b) The business activity is performed both in and outside this state and, based on costs of performance, a greater proportion of the business activity is performed in this state than is performed outside this state.

Thus, resolution of this dispute turns on whether petitioner's mixed transaction sales are sales of tangible personal property or sales of a service. In the event petitioner's sales are sales of tangible personal property, then the transactions are sourced by "destination" under MCL 208.52 and are not included in the Michigan sales numerator. Alternatively, if the mixed transaction sales are sales of a service, then the transactions are sourced according to "cost of performance" under MCL 208.53 and, consistent with respondent's audit, are properly included in the Michigan sales numerator.

C. PETITIONER'S ARGUMENTS

Petitioner first argues that the plain language of the SBTA—mainly the definition of sales in MCL 208.7—mandates that mixed transactions sales be categorized as sales of tangible personal property and that *Catalina Mktg's* incidental-to-service test is inapplicable to this inquiry because its mixed transactions sales are divisible. Petitioner did not raise these arguments in the proceedings below and they are not properly preserved for appellate review. See *Michigan AFSCME Council 25 v Woodhaven-Brownstown Sch Dist*, 293 Mich App 143, 147; 809 NW2d 444 (2011).

Petitioner's failure to properly preserve these arguments does not necessarily preclude our consideration of these legal questions. However, petitioner has consistently conceded from the very beginning of this litigation that *Catalina Mktg* articulates the appropriate standard for determining whether its mixed transaction sales constitute the sale of tangible personal property or the sale of a service. Therefore, we conclude that petitioner has waived these arguments. Indeed, "[a] party may not take a position in the trial court and subsequently seek redress in an appellate court that is based on a position contrary to that taken in the trial court." *Living*

> (*iii*) The rental, lease, licensing, or use of tangible or intangible property which constitutes business activity.

Alternatives for the Developmentally Disabled, Inc v Dep't of Mental Health, 207 Mich App 482, 484; 525 NW2d 466 (1994).[5]

Petitioner next argues that the tribunal erred by concluding that this matter is "legally indistinguishable" from *Midwest Bus*, in which this Court applied the *Catalina Mktg* test to a SBT apportionment dispute involving a mixed transaction sale. We disagree. Under the incidental-to-service test, courts "look[] objectively at the entire transaction to determine whether the transaction is principally a transfer of tangible personal property or a provision of a service." *Catalina Mktg*, 470 Mich at 24-25. Six factors are relevant to "determining whether the transfer of tangible property was incidental to the rendering of personal or professional services," including:

> what the buyer sought as the object of the transaction, what the seller or service provider is in the business of doing, whether the goods were provided as a retail enterprise with a profit-making motive, whether the tangible goods were available for sale without the service, the extent to which intangible services have contributed to the value of the physical item that is transferred, and any other factors relevant to the particular transaction. [*Id*. at 26.]

Midwest Bus, 288 Mich App 334, applied this test to a sales apportionment SBTA dispute. There, the mixed transaction sales involved the sale of bus parts, as well as the "disassembling, removing, repairing, inspecting, reconditioning, rebuilding, replacing, restoring, painting, servicing, cleaning, testing, and reassembling various components and parts of the buses." *Id*. at 345. Applying the *Catalina Mktg* factors, this Court concluded that the sale of parts was incidental to the provision of services and that the transactions were appropriately allocated to Michigan. *Midwest Bus*, 288 Mich App at 347. Regarding the first factor, the Court noted that "the buyer sought the service of having its buses rehabilitated." *Id*. Applying the second factor, the Court acknowledged that the taxpayer was in the business of selling separately bus parts and bus parts plus services, but that in the context of the mixed transactions the taxpayer was in the business of providing rehabilitation services. *Id*. With respect to the third and fourth factors—whether the goods were provided as a retail enterprise and available for sale without the service—the Court concluded that the provision of parts was "merely a means to accomplish the contractual objective of rehabilitating the buses." *Id*. at 348. The Court agreed with the Court of Claims regarding the fifth factor—the extent to which the services contribute to the value of the physical item transferred—that "there would be no remanufacturing but for the service" and that, under the sixth factor, there were no additional factors relevant for consideration. *Id*. (internal quotation marks omitted).

Here, the tax tribunal analogized this matter to *Midwest Bus* in applying the *Catalina Mktg* factors. The tribunal explained, that like the taxpayer's customers in *Midwest Bus*,

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[5] In any case, we note that petitioner's arguments in this regard lack merit because our Supreme Court has indicated by order that *Catalina Mktg's* incidental-to-service test applies in the context of the SBTA. See *Embossing Printers, Inc v Dep't of Treasury*, 474 Mich 1086; 711 NW2d 339 (2006).

petitioner's customers sought "to extend the life of the engine, and therefore, sought the service of rehabilitating the engines." The tribunal noted that "petitioner is both in the business of selling parts and rehabilitating engines," but concluded like in *Midwest Bus*, that petitioner "was not acting as a retailer but rather as the servicer." In support, the tribunal referenced the ALJ's finding that petitioner's Beech Grove Amtrak contract, involved "'substantial services, including disassembling the engine, diagnosing problems, cleaning, reconditioning, repairing damaged tapped holes, welding re-assembly, and painting.'" The tribunal also noted that, like in *Midwest Bus*, petitioner is in the business of selling parts and rehabilitation services, but that the purchase of parts in the context of the mixed transaction sales is merely a means to accomplish the contractual objective of rehabilitating the engines and that the service of rehabilitation substantially extends the life of the engine. Given the apparent similarities between this case and *Midwest Bus*, we cannot conclude that the tribunal's reliance on *Midwest Bus* was legally erroneous.

Petitioner, however, contends that *Midwest Bus* is factually distinguishable because, unlike *Midwest Bus*, its mixed transaction contracts were not "fleet" contracts, it does not "remanufacture" engines, and its mixed contracts are easily divisible into the sale of tangible personal property and services. These factual dissimilarities are insignificant and do not render a different result under the *Catalina Mktg* factors. The fact that petitioner does not provide services to entire "fleets" of locomotives is immaterial; indeed, the fact that the taxpayer in *Midwest Bus* serviced "fleets" was not relevant to the Court's analysis. Petitioner's assertion that it does not, unlike the taxpayer in *Midwest Bus*, remanufacture engines and that its "overhaul" of the engines was not extensive enough to increase the value of the engine, is simply belied by the record. The mixed transactions contracts petitioner submitted, much like those in *Midwest Bus*, provide detailed specifications for remanufacturing customer's locomotive engines, a service that was purchased for the object of extending the life of the engine. It is likewise immaterial that the ALJ here, unlike in *Midwest Bus*, found that the mixed transaction could be divided into the sale of parts and services. Whether a mixed transaction may be divisible is not a factor to consider under *Catalina Mktg.* Moreover, the provision of the engine parts and the rehabilitation service were not truly separate transactions—they were invoiced on the same order and were part of a single transaction intended, as a whole, to extend the life of the engine. Accordingly, petitioner's argument that the tribunal erred by relying on *Midwest Bus* is unavailing.[6]

[6] Petitioner also argues that the tribunal erred by relying on *Midwest Bus* because *Midwest Bus* failed to apply the clear language of the SBTA and because *Midwest Bus*'s statutory analysis regarding MCL 208.3 (defining "business activity") and MCL 208.52 amounts to a "ruling that is nonbinding dicta." Petitioner's argument that *Midwest Bus* failed to apply the SBTA's clear statutory language is a reference to petitioner's argument that the plain language of the SBTA mandates that mixed transaction sales be categorized as sales of tangible personal property. This argument is unavailing because, as explained in this opinion, petitioner conceded to the application of *Catalina Mktg*. To the extent that *Midwest Bus* contains erroneous dicta also does not provide grounds for concluding that legal error occurred because the tribunal did not rely on this portion of *Midwest Bus*.

Finally, regardless of *Midwest Bus*'s applicability, we conclude, contrary to petitioner's argument, that competent, material, and substantial evidence supports the tribunal's conclusion that the mixed transactions sales are principally the sale of a service because petitioner's customers primarily "sought the service of rehabilitating the engines." Viewing these mixed transaction sales as a whole, it is clear that petitioner's customers essentially contracted with petitioner to extend the life of their engines, which could be doubled by the rehabilitation services petitioner provided. Indeed, the Beech Grove Amtrak contract, referenced by the tribunal in support, reflects that the object of these mixed transaction sales is the provision of a rehabilitative service—the specification for the remanufacture of the engine lists extensive rehabilitative services, including disassembling, cleaning, rebuilding and repairing parts, welding, testing, reassembling, and painting. Moreover, although petitioner is in the business of selling parts and providing installation services, we agree with the tribunal that when the mixed transaction sales are viewed as a whole, petitioner was in the business of providing rehabilitation services to its locomotive customers. Indeed, as the Beech Grove Amtrak contract demonstrates, the purchase of parts was merely a means to accomplish the contractual objective of rehabilitating engines. In the context of these mixed transactions, petitioner thus sold the engine parts in furtherance of petitioner's services enterprise, not in furtherance of its retail enterprise. The final tangible product—a completely rehabilitated engine with an extended life—would not have been available for sale without the service. As the tribunal recognized, based on the testimony of petitioner's controller, these services doubled the life of the engine and added substantial value to the end product. Accordingly, we conclude that competent, material, and substantial evidence supports the tribunal's conclusion that the sale of the engine parts is incidental to the sale of the rehabilitation services.[7]

IV. CONCLUSION

[7] Contrary to our conclusion, petitioner contends that application of *Catalina Mktg* test mandates the conclusion that its mixed transaction sales are sales of tangible personal property. However, given the record evidence, it is unconvincing that the primary object of these transactions is simply the sale of parts. Petitioner contends that because it is not itself a consumer of the parts used to rehabilitate its customers' engines and because the mark-up on the parts is the same regardless of whether the service is provided or not, that it provided the parts in furtherance of its retail enterprise. This argument ignores that the main object of the transaction was the provision of rehabilitation services to obtain a newly rehabilitated engine with an extended life. Petitioner also suggests that because "most of the time" it sells only parts, that its mixed transactions are for the sale of tangible personal property. However, in considering the *Catalina Mktg* factors, we must be mindful that "[t]he focus belongs on the transaction, not the character of the participants." *Catalina Mktg*, 470 Mich at 26, citing 68 Am Jur 2d, Sales and Use Taxes, § 62 pp 51-52. That petitioner also sells parts, then, is immaterial when considering the nature of the transactions at issue.

The tax tribunal did not err by concluding that the essence of petitioner's mixed transaction sales is the provision of a service and that the sale of parts is merely incidental to that primary object. Therefore, the tribunal correctly upheld respondent's characterization of petitioner's mixed transaction sales as sales of a service and apportionment of these sales to Michigan under MCL 208.53 for the tax years in issue.

Affirmed.

/s/ Patrick M. Meter
/s/ Deborah A. Servitto
/s/ Michael J. Riordan